Table 6.10. Production combination builders: net profit

	2010		2012		2014	
	Average ($1,000s)	Share of revenue (%)	Average ($1,000s)	Share of revenue (%)	Average ($1,000s)	Share of revenue (%)
Gross profit	2,322	12.6	4,944	16.5	6,797	20.4
Operating expenses						
Financing expenses	347	1.9	607	2.0	460	1.4
Sales & mktg. expenses	728	4.0	1,669	5.6	2,006	6.0
General & administrative expenses	707	3.9	1,436	4.8	1,270	3.8
Owner's compensation	165	0.9	180	0.6	295	0.9
Total operating expenses	1,947	10.6	3,892	13.0	4,031	12.1
Net profit (loss)	**375**	**2.0**	**1,051**	**3.5**	**2,766**	**8.3**

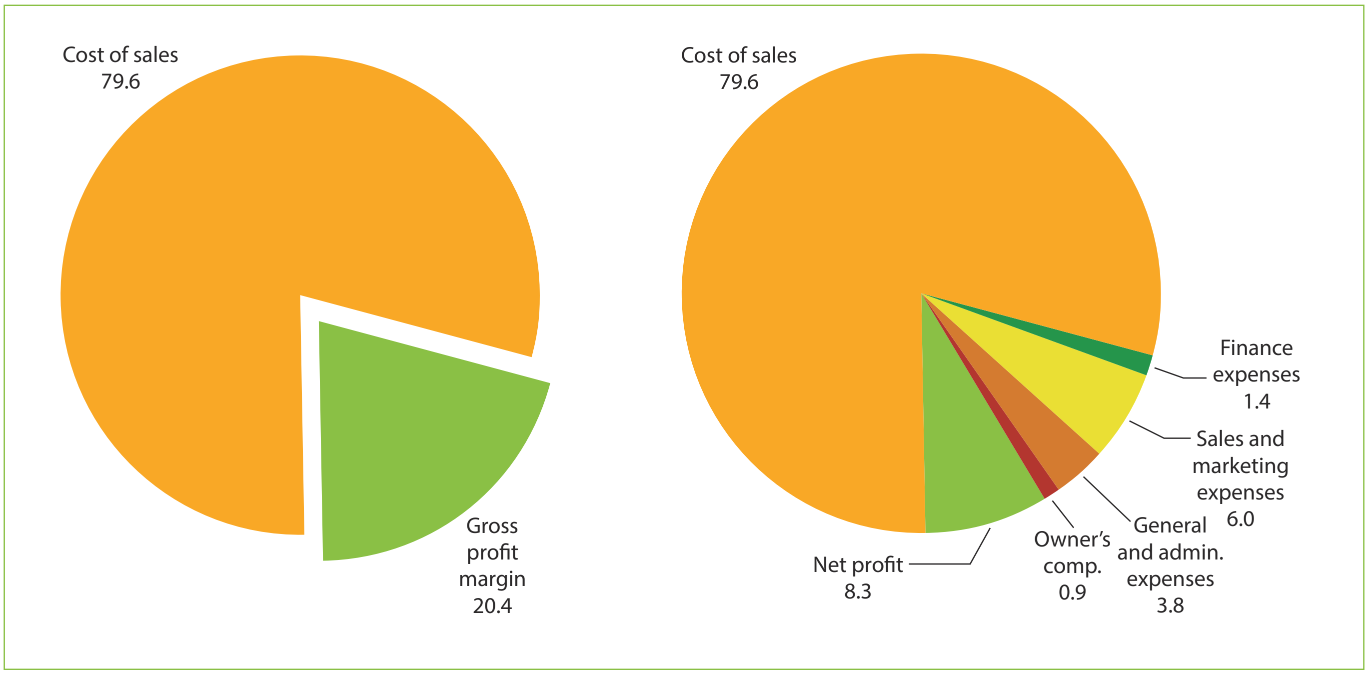

Figure 6.3. Production combination builders: cost of sales, expenses, and net profit (% of revenue)

million to $7.8 million. As a result, 42.5% of assets in 2014 were backed up by equity, an increase from the 35.8% reported in 2012.

Financial ratios for production combination builders were healthier in 2014. A robust increase in current assets led the current ratio to increase to 1.81 from 1.70 in 2012, which once again implies they have 1.81 times more current assets than current liabilities. Falling debt levels favorably brought down the debt-to-equity ratio to 1.35 from 1.80 in 2012, while higher profits drove ROA to triple from 5.8% to 15.0 and ROE to double from 16.3% to 35.2% (table 6.12).

Table 6.11. Production combination builders: balance sheet

	2010		2012		2014	
	Average ($1,000s)	Share of total (%)	Average ($1,000s)	Share of total (%)	Average ($1,000s)	Share of total (%)
Assets						
Current assets						
Cash	776	7.0	969	5.4	944	5.1
Construction work in progress	8,847	79.9	12,223	67.6	14,702	79.7
Other current assets	726	6.6	2,534	13.0	1,919	10.4
Total current assets	10,349	93.5	15,535	86.0	17,566	95.3
Other assets	725	6.5	2,534	14.0	876	4.7
Total assets	**11,074**	**100.0**	**18,069**	**100.0**	**18,442**	**100.0**
Liabilities						
Current liabilities	1,864	16.8	3,218	17.8	2,868	15.5
Construction loans	3,046	27.5	5,917	32.7	6,832	37.0
Total current liabilities	4,910	44.3	9,135	50.6	9,699	52.6
Other liabilities	1,166	10.5	2,473	13.7	896	4.9
Total liabilities	**6,076**	**54.9**	**11,608**	**64.2**	**10,595**	**57.5**
Owner's equity	**4,997**	**45.1**	**6,461**	**35.8**	**7,847**	**42.5**
Total liabilities & owner's equity	**11,074**	**100.0**	**18,069**	**100.0**	**18,442**	**100.0**

Table 6.12. Production combination builders: financial ratios

	2010	2012	2014
Current ratio	2.11	1.70	1.81
Debt-to-equity ratio	1.22	1.80	1.35
Return on assets (%)	3.40	5.80	15.00
Return on equity (%)	7.50	16.30	35.20

7

Builder Financial Performance by Region and Business Model

About 93.5% of all revenue earned in 2014 by single-family builders responding to the survey came from single-family home building. Other activities represented only small shares of builders' revenue: 2.3% came from multifamily building, 1.2% from residential remodeling, 0.3% from light commercial/industrial building, and 2.7% from 'other' sources.

Revenue and Profits by Region

Compared across regions, builders in the South had the highest share of revenue from single-family home building, 96.6%, followed by the Midwest (94.5%) and the West (88.2%). Data are not available for the Northeast because the low number of responses received from this region (which is also the region with the fewest housing starts) makes estimates statistically unreliable.

Land in the Midwest cost builders 8.3% of all their 2014 revenue, a significantly lower share than in the West (15.6%) or South (14.7%). Single-family direct construction costs were a different story: they were higher (relative to income) in the Midwest, at 65.0%, than in the South (63.1%) or the West (56.0%) (fig. 7.1). After accounting for all cost of sales, builders in the Midwest posted a gross profit margin of 20.9%, higher than in the South (18.3%) or the West (17.8%).

The share of revenue spent on operating expenses was rather consistent across regions of the country, varying only from 11% in the West, to 12.2% in the South, and 13.6% in the Midwest. After these expenses were subtracted from gross profit, builders in the Midwest posted a 7.3% net profit margin, the highest of the three regions. It was 6.8% in the West and 6.1% in the South.

These results show that builders' bottom lines continued to improve nationwide in 2014, as every region posted a better net margin than in 2012 (5.2% for the Midwest and West, and 3.5% for the South), which was in turn better than 2010 (0.9% for the Midwest, 1.7% for the South, and –2.9% for the West).

Revenue and Profits by Business Model

In 2008, for the first time in the history of *The Cost of Doing Business Study*, builders without land costs posted a higher net profit margin (5.1%) than either combination builders (–2.5%) or those with land costs (–4.9%). The same was true in 2010, when builders without land costs averaged a 2.9% net margin, compared with 1.8% among combination builders, and –1% among those with land costs. In 2012, builders with land costs once again became the most profitable, with an average net margin of 6.2%, compared with 3.6% for combination builders and 4.2% for those without land costs.

By 2014, however, combination builders claimed the spot as the most profitable group of builders, with an average net profit margin of 7.6% (fig. 7.2). With revenue averaging $15.4 million, these builders posted the strongest gross profit margin (19.5%) of the three

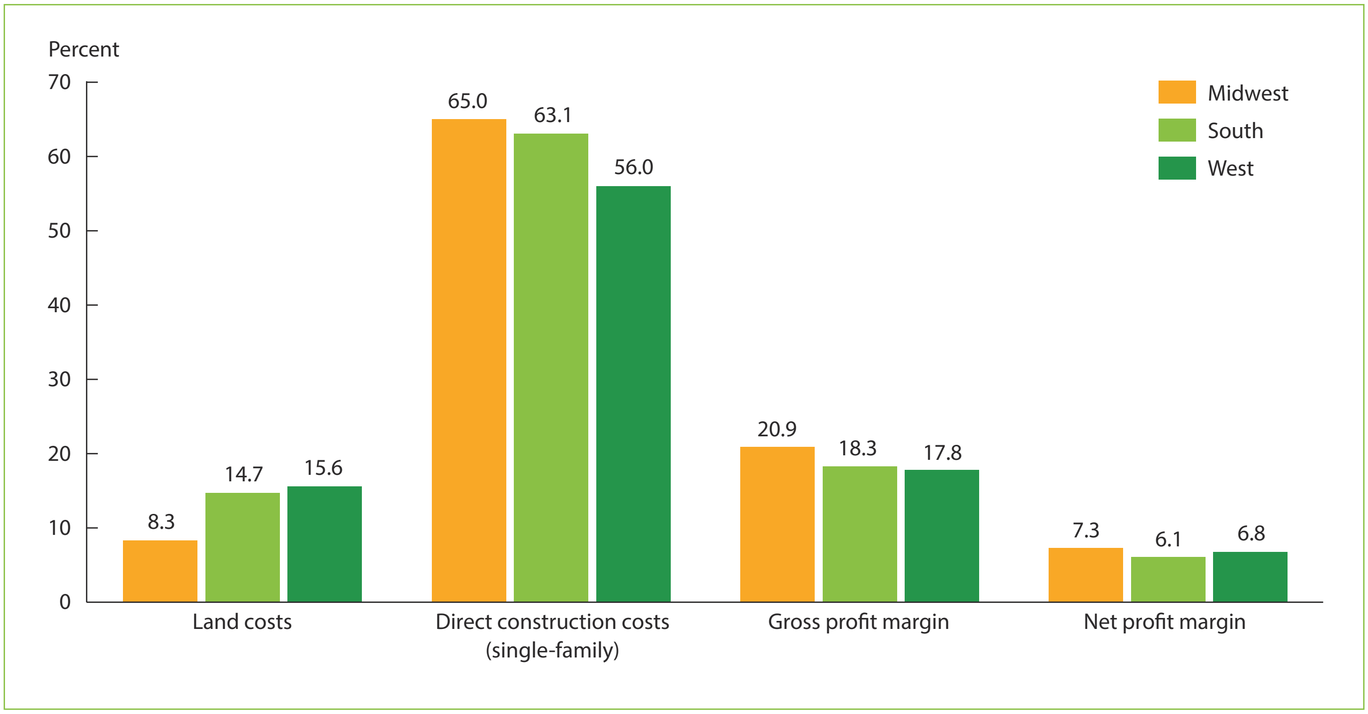

Figure 7.1. Regional differences in costs and profit margins (% of revenue)

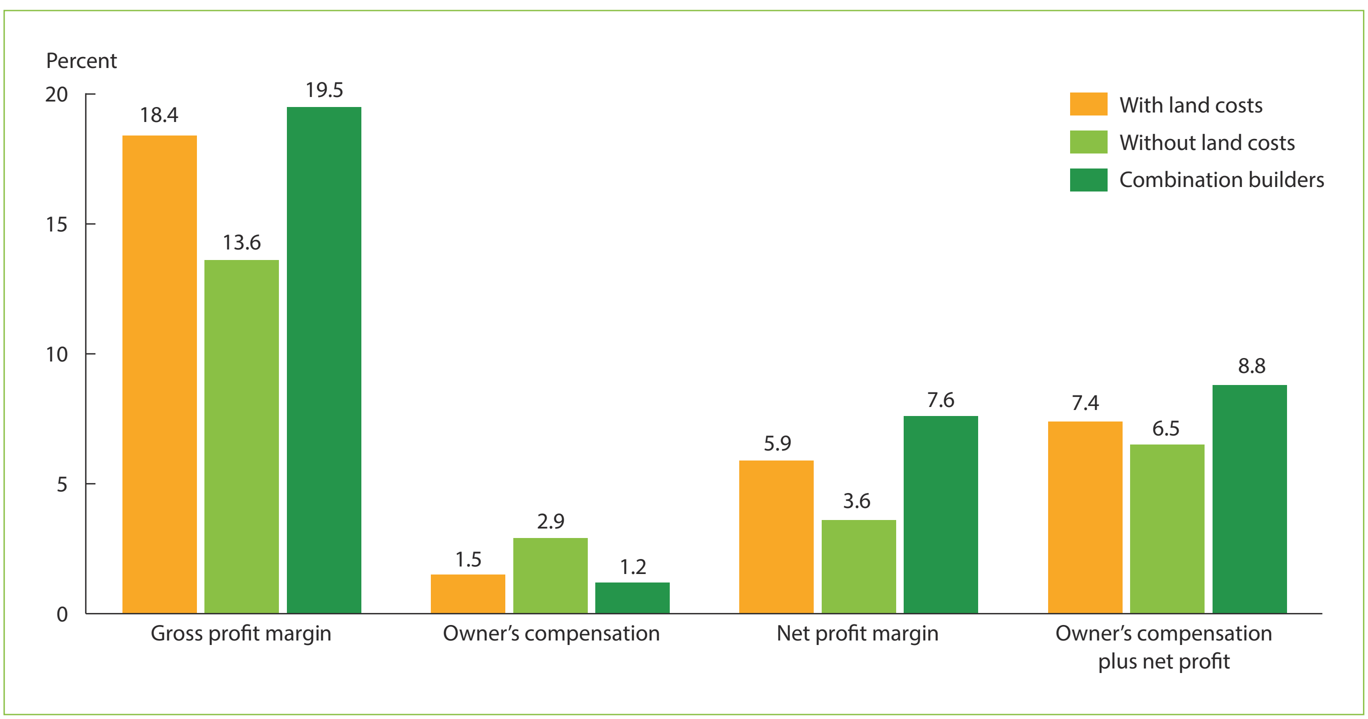

Figure 7.2. Profits and owner's compensation by business model (% of revenue)

business models analyzed, and also paid their owners the lowest share of revenue, 1.2%.

Meanwhile, builders with land costs earned an average of $20.5 million in 2014. After 81.6% of that was spent on cost of sales (including 16% on land), they averaged a gross profit margin of 18.4%. They spent 12.5% on operating expenses, including 1.5% on owner's compensation. In the end, builders with land costs earned a net profit margin of 5.9%.

Builders without land costs had much lower revenue, $4.9 million on average, but the highest cost of sales (86.4%) of all three business models. This led them to have the lowest gross margin (13.6%). They spent 10.1% of revenue on operating expenses, including 2.9% on owner's compensation, which left them with a net profit margin of 3.6%—the lowest of the three business models.

Another useful way to compare overall performance is by adding the net profit margin to the share spent on owner's compensation. According to this broader measure of profitability, combination builders had better performance (8.8%) than builders with land costs (7.4%), or those without land costs (6.5%). When compared to 2012, these results show improvement among combination builders and those with land costs, as their overall rate of profitability that year was 4.3% and 6.6%, respectively. Results are slightly less positive in 2014 for builders without land costs, as their overall measure of profitability was 7.1% in 2012.

Builders with land cost had the highest total assets of the three business models, an average of $13.6 million (fig. 7.3). Of that amount, $9.1 million was held as construction work in progress and $1 million was cash. Their total liabilities averaged $10.2 million (75.1% of assets), while owner's equity averaged $3.4 million (24.9% of assets).

Combination builders had the second highest level of assets, averaging $9.4 million. Of that amount, $7.0 million was tied to construction work in progress and only $592,000 was cash. Their average liabilities were $5.6 million (60.2% of assets) and their average equity was $3.7 million (39.8% of assets).

Builders without land costs had the lowest average assets ($1.3 million). About $214,000 was cash, $451,000 was construction work in progress, and $403,000 was other current assets. This group of builders reported owing $980,000 (74.5% of assets) in total liabilities and having $335,000 in equity (25.5% of assets).

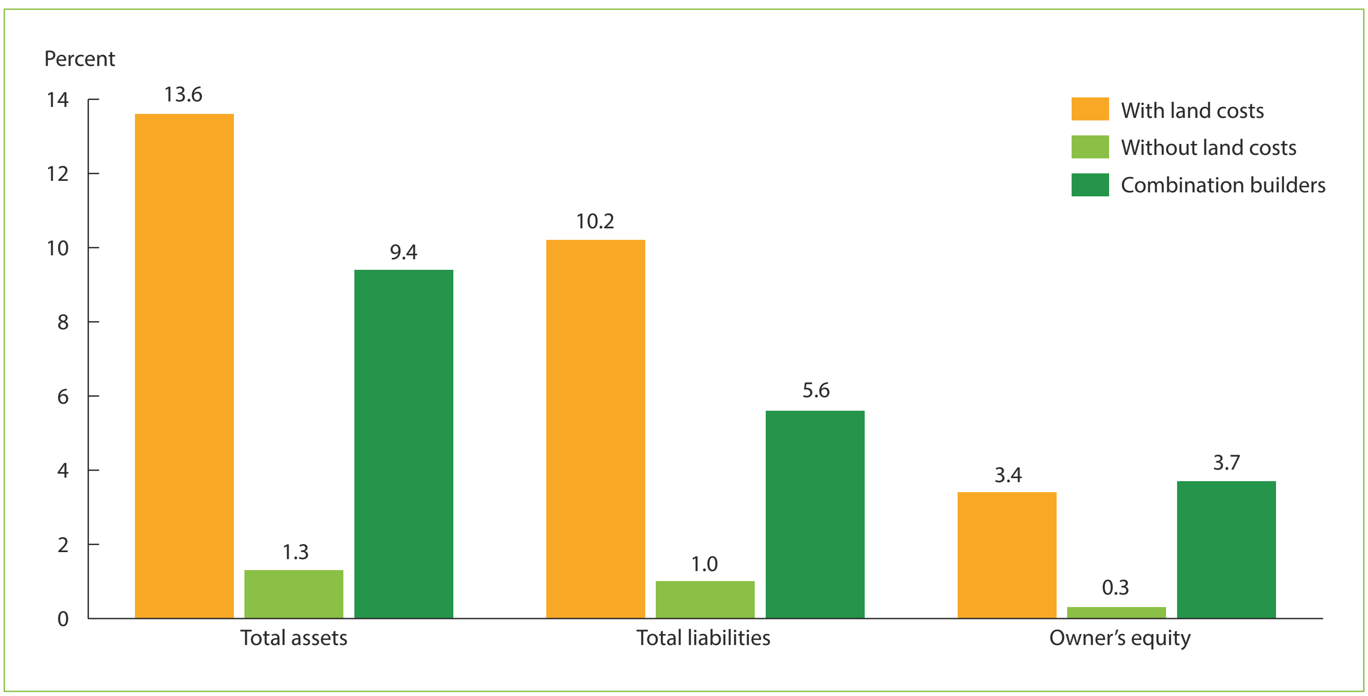

Figure 7.3. Balance sheet by business model ($ averages in millions)

8

Operations

Of the 86% of survey respondents who reported single-family home building as their primary operation in 2014 (fig. 8.1), 33% were production builders, 31% were custom builders (on the owner's lot), and 22% were custom builders (on the builder's lot). About 9% of respondents were primarily residential remodelers, 2% were multifamily builders (condo/co-op units), and 1% were land developers. As stated previously, only respondents whose primary operation was single-family home building were included in the financial analysis presented throughout this report.

Number of Years in Business

Among the single-family builders responding to the survey, 31% have been in the residential construction business for 10 years or less, 18% for 11 to 19 years, 21% for 20 to 29 years, and 29% for 30 years or more (fig. 8.2). On average, respondents have been in business for 22 years.

Total revenue earned in 2014 was positively related to how long the company has been in business. Among those with less than $2 million in revenue, for example, average tenure in the industry was 15 years, compared to an average

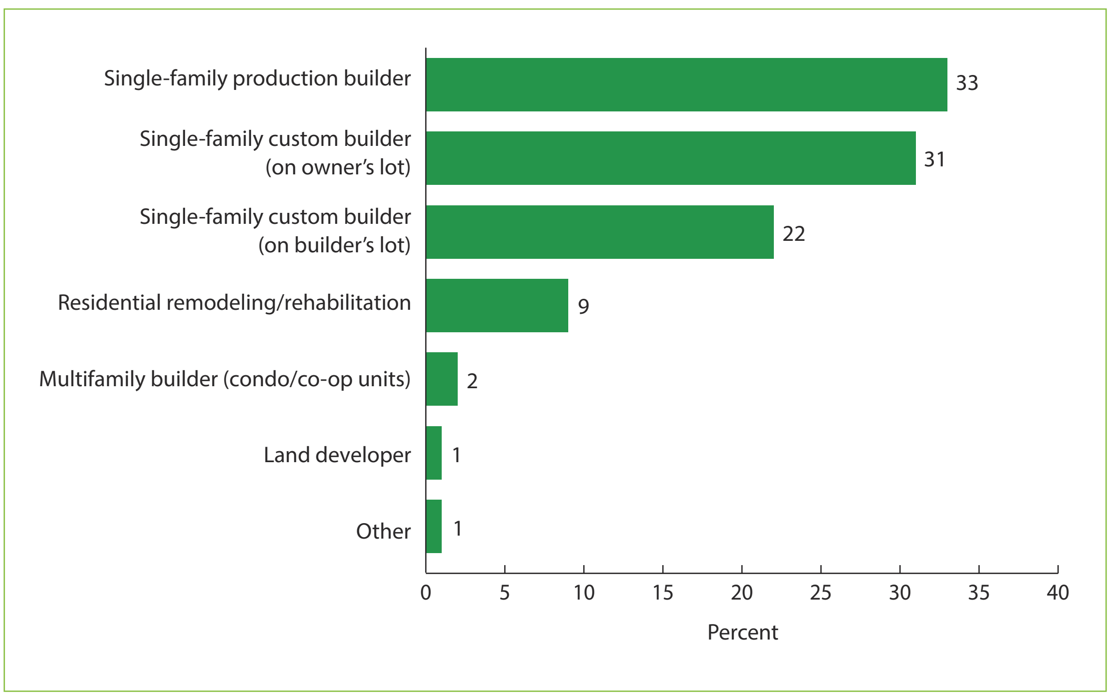

Figure 8.1. Main operation (% of respondents)

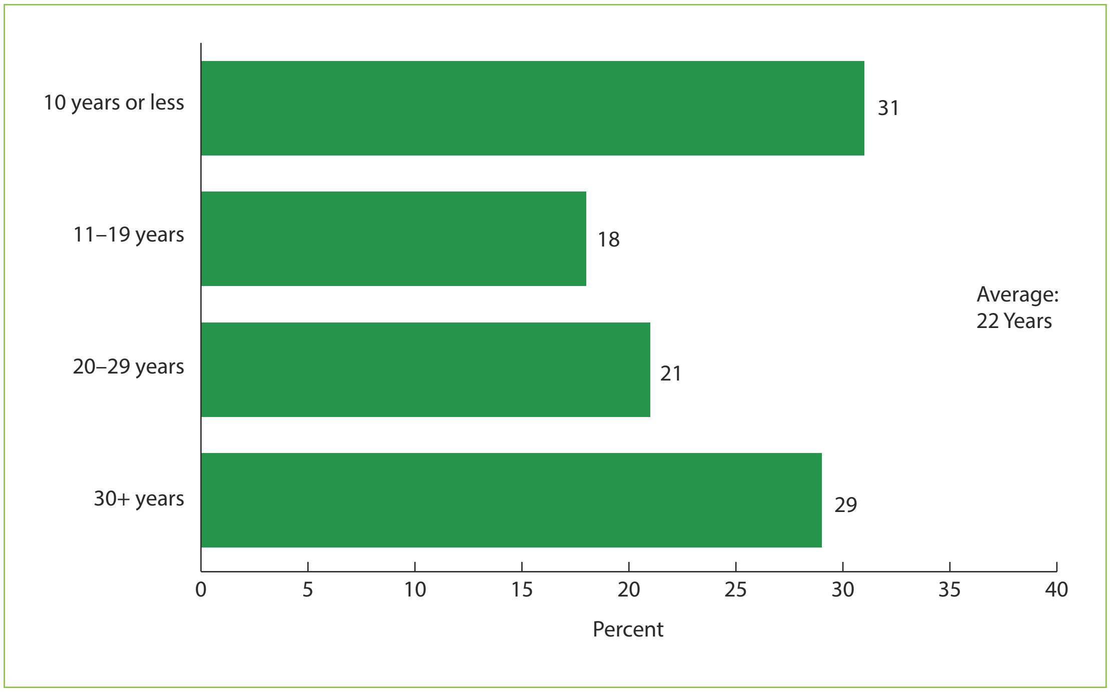

Figure 8.2. Years in the residential construction business (% of respondents)

of 21 years among those earning $2 million to $9.9 million, and 27 years among those with revenue of $10 million or more (Appendix V.1).

A breakdown by number of homes closed also shows that tenure tended to increase with the number of closings. Builders who closed fewer than 10 homes in 2014 have been in business an average of 21 years, and those with 10 to 25 closings, an average of 19 years. In contrast, builders with 26 to 99 closings, and those with 100 or more, have been in business for 25 years and 28 years, respectively.

Units Closed: Presold, Speculative, or on Customers' Land

Respondents closed an average of 42 single-family homes in 2014, slightly fewer than the 46 closed by builders responding to the 2012 survey, but far more than reported in both 2008 and 2010 (24). Average closings are still below the peak of 52 reached in 2006. As figure 8.3 shows, 19 of the 2014 closings (44%) were presold homes on the builder's lots, 18 (42%) were speculative, and 6 (14%) were built on the owner's land. Data from the U.S. Census Bureau on the purpose of construction show that 71% of all single-family units started in 2014 were built for sale (either presold or spec), 17% were built on the owner's land by a contractor, 8% were built directly by the owner, and 4% were built for rent.[3]

Builders with land costs closed an average of 64 single-family homes in 2014 (34 presold, 30 speculative), only a couple more than in 2012 (62), but a significant increase from the 34 closed in 2008 and 2010. Their production is still below 2006 levels, though—that year they reported 80 closings! Builders without land costs closed an average of 13 homes on the owner's land, the same number as in 2012, but more than in 2010 (10), 2008 (9), or 2006 (12). Combination builders, meanwhile, closed on 41 homes in 2014, significantly fewer than in 2012 (57), but more than in 2010 (29), 2008 (30), and about the same as in 2006 (42). Of the 41 closings, 17 were presold, 18 speculative, and 6 were built on the owner's land.

3. Because this study includes only presold and contractor-built units, and therefore has a smaller base, the distribution of units started by purpose of construction differs from U.S. Census Bureau data.

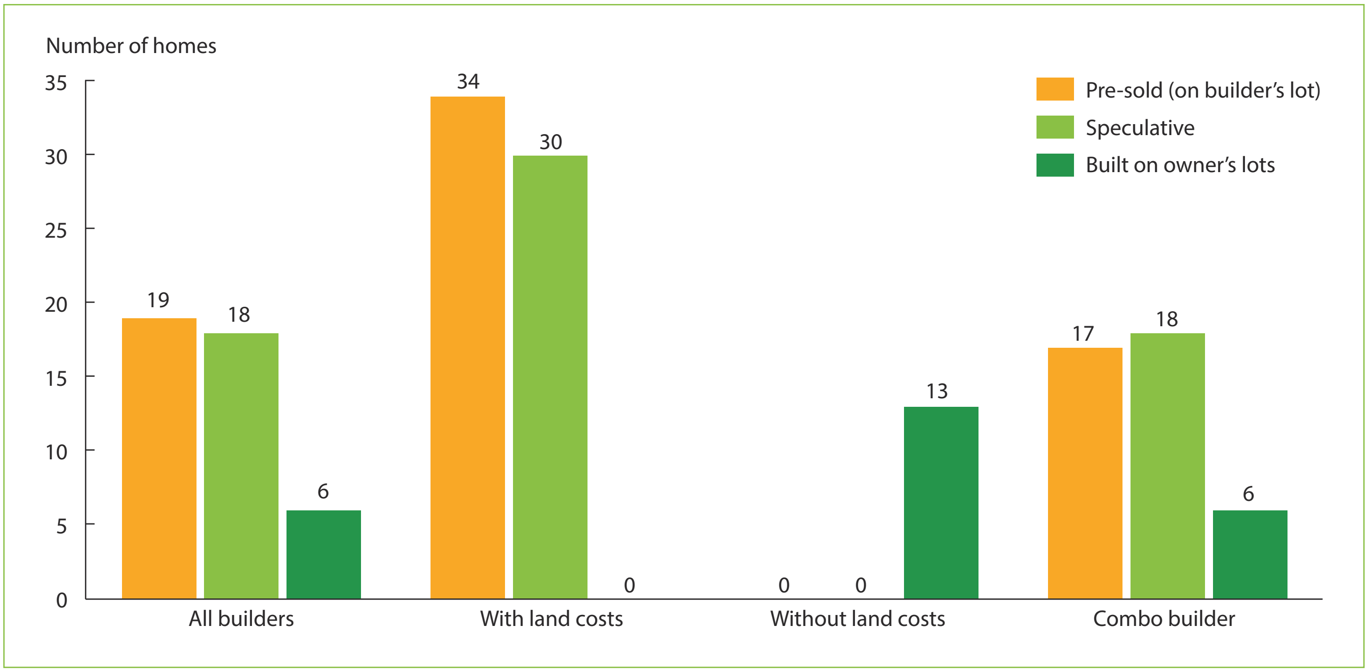

Figure 8.3. Average number of homes closed in 2014 by type of builder

9

Historical Data and Trends

Single-family builders continue to emerge from the depths of the housing recession of the late 2000s. After posting a –3.0% net profit margin in 2008, and barely breaking even in 2010 (0.5%), they have posted two consecutively higher net rates of return since then: 4.9% in 2012 and 6.4% in 2014. In fact, the 6.4% net margin for 2014 is higher than the average for the previous 30 years: from 1985 to 2014, the average net margin reported in *The Cost of Doing Business Study* has been 5.1% (table 9.1).

Table 9.1. Summary Data from the NAHB Cost of Doing Business studies (% of revenue)

				Operating expenses breakdown					
	Total sales	Cost of sales	Gross profit	Finance	Sales and marketing	General & administrative	Owner's compensation	Total operating expense	Net income before tax
2014	**100.0%**	**81.1%**	**18.9%**	**1.4%**	**5.0%**	**4.7%**	**1.3%**	**12.5%**	**6.4%**
2012	100	82.6	17.4	1.7	5.1	5.0	0.8	12.5	4.9
2010	100	84.7	15.3	2.1	5.2	5.8	1.6	14.7	0.5
2008	100	85.6	14.4	2.8	5.4	7.5	1.7	17.4	(3.0)
2006	100	79.2	20.8	2.5	4.4	5.0	1.3	13.1	7.7
2004	100	79.1	20.9	1.5	4.7	5.4	1.3	12.9	8.0
2002	100	81.1	18.9	0.6	2.6	5.9	4.5	13.6	5.4
2000	100	80.1	19.9	2.2	5.7	3.9	1.8	13.5	6.3
1996	100	82.4	17.6	1.5	3.3	5.0	3.4	13.2	4.4
1993	100	79.4	20.6	1.9	4.0	5.1	5.0	16.0	4.6
1991	100	78.0	22.0	3.0	4.0	5.0		12.0	10.0
1989	100	79.1	20.9	5.6	5.2	4.8		15.6	5.3
1987	100	79.7	20.3	3.3	3.7	6.1		13.1	7.2
1985	100	81.7	18.3	3.9	3.3	7.6		14.8	3.5
1983*	100	79.7	20.3	4.5	3.3	8.8		17.6	2.7
1980*	100	77.2	22.8	2.0	2.5	9.4		16.9	5.9
1978	100	76.1	23.9	2.7	3.6	5.5		16.9	7.0
1975	100	84.1	15.9	2.8	2.3	7.5		11.6	4.3
1970	100	82.4	17.6	3.3	3.0	6.5		14.4	3.2

* The values for 1980 and 1983 are medians.

Note: The years in this table represent the years the data was collected for, not the years in the book titles.

Source: NAHB.